

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Ionia Area Sewer Disposal System	County Ionia
Audit Date 6/30/05	Opinion Date 9/22/05	Date Accountant Report Submitted to State: 11/15/05	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Abraham & Gaffney, P.C.			
Street Address 3511 Coolidge Rd Suite 100	City East Lansing	State MI	ZIP 48823
Accountant Signature <i>Abraham & Gaffney, P.C. Aaron M. Stene</i>		Date 11/2/05	

**Ionia Area Sewage Disposal System
Ionia, Michigan**

FINANCIAL STATEMENTS

June 30, 2005

Ionia Area Sewage Disposal System

TABLE OF CONTENTS

June 30, 2005

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	i
MANAGEMENT'S DISCUSSION AND ANALYSIS	ii-vii
BASIC FINANCIAL STATEMENTS	
Statements of Net Assets	1
Statements of Revenues, Expenses, and Changes in Fund Net Assets	2
Statements of Cash Flows	3-4
Notes to Financial Statements	5-11
OTHER SUPPLEMENTARY INFORMATION	
Schedule of Revenues, Expenses, and Changes in Fund Net Assets - Amended Budget and Actual	12-13

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INDEPENDENT AUDITOR'S REPORT

Ionia Area Sewage Disposal System
Ionia, Michigan

We have audited the accompanying basic financial statements of the Ionia Area Sewage Disposal System as of and for the year ended June 30, 2005 and 2004, as listed in the Table of Contents. These basic financial statements are the responsibility of the Ionia Area Sewage Disposal System's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Ionia Area Sewage Disposal System as of June 30, 2005 and 2004, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as identified in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the accounting principals generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Ionia Area Sewage Disposal System's basic financial statements. The other supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

September 22, 2005

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

The intent of the management discussion and analysis is to provide highlights of the Agency's financial activities for the Fiscal Year ended June 30, 2005. Readers are encouraged to read this section in conjunction with the transmittal letter and the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- ❖ **Net Assets:** The assets of the Sewage Disposal System (SDS) exceeded its liabilities by \$7.9 million. Of this amount, \$329,248 (unrestricted net assets) may be used to meet the SDS's ongoing obligations to citizens and creditors. The total net assets increased by \$100,222. Total assets were slightly less than one year ago. Capital projects were started and recorded as Construction in Progress which used up some cash. However, unfunded depreciation reduced the Capital Assets, which resulted in a decrease of total assets by \$72,851. Liabilities decreased despite the bond issue on June 7, 2005. Principal was paid on existing debt so the decrease in liabilities was a net of \$173,073.
- ❖ **Operating Revenues and Expenses:** Revenues were higher for the fiscal year ending June 30, 2005. Expenses for Administrative costs include bond issuance costs from the June 7, 2005 bond. Fringes and Salaries were higher than last year as a result of staffing levels. Last year one of the operators was on military leave and was on payroll for about half of the fiscal year. In addition, a new hire in 2004 received step increases for length of service.
- ❖ **Non-Operating Revenues and Expenses:** Investment income was \$6,096 more than a year ago from the long term investment earnings. The SDS paid for half of the debt payment on the special assessment bond in the Skyview subdivision that had reverted back to the City. When the improved lots were taken back by the City, the subsequent sale to a developer was made with the knowledge that the City and SDS would be responsible for the future bond payments on the improvements which included a lift station to handle future projected flows. In addition, the SDS received land from the transfer on which the lift station and other future improvements can be located. The restriction of these properties and control of the improvements allows for potential future growth without the need to acquire such assets. This bond will be retired October 2010.
- ❖ **Deferred Revenue:** In November 2001, Easton Township decided to have the City bill their sewer customers for actual usage instead of the township billing them a flat fee. At this point, the township also chose to pay off their portion of existing debt based on their previous percentage of ownership. The township paid \$203,270, which was determined to be their percentage of total debt on Oct 22, 2002. This amount was set up as restricted cash and deferred revenue. It is shown as earned revenue as each semi-annual payment is made on the existing debt. The FY 04-05 portion of township debt that was applied was \$16,143. Interest earned on this restricted cash is also kept separate and will be recognized as the payments are recorded. The FY 04-05 portion of township interest was \$3,823. Township customers therefore are not billed for debt service on their quarterly bills.

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report includes this management's discussion and analysis report, the independent auditor's report and the basic financial statement of the Sewage Disposal System, which include notes that explain in more detail some of the information in the financial statements.

As a municipal wastewater treatment plant, the Ionia Area Sewage Disposal System engages in primarily enterprise operations in various separate and distinct activities. These activities include but are not limited to: 1) acquisition and construction of collection and plant facilities and treatment of domestic and industrial wastewater; 2) maintenance of sanitary sewers and storm sewers; 3) lift station operation and maintenance. The SDS was created by the City of Ionia, and Ionia, Berlin and Easton Townships to provide for the collection, treatment and disposal of sewage for the benefit of their constituents. The service area includes all of the City of Ionia and the more intensely developed areas of the townships adjacent to the City.

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

REQUIRED FINANCIAL STATEMENTS

The financial statements report information of the Sewage Disposal System (SDS) using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The Statement of Net Assets includes all of the SDS's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to SDS creditors (liabilities). It also provides the basis for evaluating the capital structure of the SDS and assessing the liquidity and financial flexibility of the SDS.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the SDS's operations over the past year and can be used to determine whether the SDS has successfully recovered all of its costs through its user fees and other charges, profitability and credit worthiness.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing, and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

FINANCIAL ANALYSIS OF THE SDS

The Statement of Net Assets and the Statement of Activities provide information to determine how the SDS did financially during FY 04-05. The net assets, or the difference between assets and liabilities, and the changes in them can indicate whether financial health is improving or deteriorating overtime. However, other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation also need to be considered in determining the SDS financial health.

NET ASSETS

The SDS's Condensed Statement of Net Assets and Statement of Revenue, Expenses and Changes in Fund Net Assets are presented in the following Tables. A comparative analysis of data is presented from the fiscal year of 2003-2004.

TABLE 1
CONDENSED STATEMENT OF NET ASSETS

	<u>As of 6/30/2005</u>	<u>As of 6/30/2004</u>
Current Assets	\$ 1,714,821	\$ 2,021,611
Capital Assets	<u>10,580,632</u>	<u>10,346,693</u>
Total Assets	12,295,453	12,368,304
Current Liabilities	693,599	747,744
Noncurrent Liabilities	<u>3,613,591</u>	<u>3,732,519</u>
Total Liabilities	4,307,190	4,480,263
Invested in Capital Assets		
Net of Related debt	7,020,526	6,826,118
Restricted	638,489	795,840
Unrestricted	<u>329,248</u>	<u>266,083</u>
Total Net Assets	<u>\$ 7,988,263</u>	<u>\$ 7,888,041</u>

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

TABLE 2
CONDENSED STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

	FY 04-05	FY 03-04
Operating Revenues	\$ 1,005,956	\$ 934,684
Non-operating Revenues	<u>574,201</u>	<u>573,661</u>
Total Revenues	1,580,157	1,508,345
Depreciation Expense	331,062	318,443
Other Operating Expense	938,710	970,089
Non-operating Expense	<u>210,163</u>	<u>159,036</u>
Total Expenses	<u>1,479,935</u>	<u>1,447,568</u>
Changes in Net Assets	100,222	60,777
Beginning Net Assets	<u>7,888,041</u>	<u>7,827,264</u>
Ending Net Assets	<u>\$ 7,988,263</u>	<u>\$ 7,888,041</u>

While the Statement of Net Assets shows the change in financial position of net assets, the Statement of Revenues, Expenses and Changes in Net Assets shows how total revenues and expenses increased the net assets. Operating revenues of \$1,005,956, less operating expenses of \$938,710 show that the day to day operations of the treatment plant are being met by user fees. Increased rates became effective with the fiscal year beginning July 1, 2004. Each spring a rate study using Michigan Rural Water Association software is used to evaluate operating costs and determine appropriate rates to charge sewer users. The Depreciation expense of \$331,062 is a non-cash expense, which represents the reduction in the value of the facility and system.

The rate charged to municipal users is computed by taking actual operating costs and adding an \$85,000 annual replacement reserve to get a total cost that is divided by the actual usage billed to each municipality. The Annual Replacement reserve is used to pay for capital improvements such as computer upgrades, plant improvements and equipment. Participating municipalities are also billed separately for the actual debt payment due during the fiscal year. This is again computed based on usage by the municipalities.

BUDGETARY HIGHLIGHTS

The Sewage Disposal System is an enterprise fund. The City of Ionia is not required to adopt an annual budget. However, the City Council does adopt an annual Operating Budget and a five-year Capital Plan following a public hearing. This budget is also presented to the Ionia County Board of Public Works, after the Council's approval. The Operating Budget includes proposed expenses and the means of financing them. The SDS's operating budget remains in effect but can be revised with City Council approval prior to the fiscal year end.

The capital plan and annual capital expenditures are also included in the budget. The depreciation expense is recorded in the budget but is not covered by revenues. Therefore the budget is allowed to show a net loss for the year. A replacement reserve line item is budgeted to allow for capital improvements. This amount is added to the operating costs as explained in the previous section.

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

A FY 04-05 budget comparison and analysis is presented in TABLE 3.

TABLE 3
BUDGET vs. ACTUAL
FY 04-05

	BUDGETED			Variance
	ORIGINAL	FINAL	ACTUAL	Favorable (Unfavorable)
OPERATING REVENUES				
Sales and charges for services	\$ 1,022,291	\$1,011,394	\$ 981,990	\$(29,404)
Other	<u>10,290</u>	<u>26,640</u>	<u>23,966</u>	<u>(2,674)</u>
TOTAL OPERATING REVENUES	1,032,581	1,038,034	1,005,956	(32,079)
OPERATING EXPENSES				
Salaries	287,605	283,142	280,752	2,390
Payroll taxes and fringe benefits	155,247	161,884	160,342	1,542
Central garage allocation	0	50	36	14
Insurance	60,811	58,685	58,683	2
Contractual and professional	83,232	79,664	93,638	(13,974)
Operating supplies	168,230	151,535	131,635	19,900
Administration	95,447	91,719	91,718	1
Telephone	7,241	6,695	5,877	818
Transportation and training	1,133	1,733	1,729	4
Public utilities	101,764	103,942	103,935	7
Depreciation	327,818	329,948	331,061	(1,113)
Gas and oil	2,129	5,610	5,609	1
Equipment rental	0	2,355	2,352	3
Miscellaneous	309	102	24	78
Repair & maintenance supplies	<u>1,773</u>	<u>2,380</u>	<u>2,380</u>	<u>(0)</u>
TOTAL OPERATING EXPENSES	<u>1,292,739</u>	<u>1,279,444</u>	<u>1,269,772</u>	<u>9,672</u>
OPERATING (LOSS)	(260,158)	(241,410)	(263,816)	(22,407)
NONOPERATING REVENUES (EXPENSES)				
Interest revenue	38,582	43,465	46,607	3,142
Contributions from local units	630,249	539,177	527,594	(11,583)
Capital outlay	(110,000)	(110,000)	0	110,000
Replacement reserve	(85,000)	(85,000)	0	85,000
Interest expense	(626,490)	(662,266)	(174,690)	487,576
Contributions to local unit	<u>(247,377)</u>	<u>(362,690)</u>	<u>(35,473)</u>	<u>327,217</u>
TOTAL NONOPERATING REVENUE (EXPENSE)	<u>(400,036)</u>	<u>(637,314)</u>	<u>364,038</u>	<u>1,001,352</u>
NET INCOME (LOSS)	<u>\$(660,194)</u>	<u>\$(878,724)</u>	<u>\$ 100,222</u>	<u>\$ 978,946</u>

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

The cost of the Treatment Plant is allocated to the participating municipalities. Operating costs were similar to last year and billable flow was slightly less than last year. Rates charged to the municipalities went from \$1.40/1000 to \$1.44/1000 gallons, which resulted in overall additional revenue. The actual increase in revenues from the municipalities was not as much as budgeted, based on actual costs and billable flow. The Operating Supplies variances from amended budget are based on purchasing only when needed. The non-operating revenues and expenses variances are due to budget processes which are set up to show Balance Sheet activity, such as Bond indebtedness, payment of principal on debt, purchases of capital items and improvements to the system that are tracked through the Capital Projects fund. For example, the interest expense variance of \$487,576 ties to the principal on the debt that was paid during the year. The budget shows both interest and principal. In order to reduce the balance of the long term debt the principal must be reclassified to the balance sheet.

CAPITAL ASSETS

At the end of FY 04-05, the SDS had invested \$218,295 in equipment for the wastewater treatment plant. Security cameras, lab equipment, SCADA controls, a pump replacement, building improvements and 2 trucks were purchased. In addition, the SDS made improvements to the system. One hundred percent of the projects that were funded by the June 7, 2005 bond can be attributed to improvement to the SDS. The amount added to the system during this fiscal year as construction in progress was \$346,706. The SDS has a five year Asset Management Plan that includes continued improvements for controls, radios, lift station, and exterior work on the plant. Future projects that need to be bonded for and will be evaluated further include air conditioning installation and additional storage at the facility. The increase in structures, machinery & equipment, and furniture & fixtures is from additions to the system less recognizing plant asset disposals for obsolete equipment or depreciation.

TABLE 4
CAPITAL ASSETS

	<u>FY 04-05</u>	<u>FY 03-04</u>
Sewer Plant and Improvements	\$15,835,162	\$15,339,012
Machinery and Equipment	<u>189,311</u>	<u>120,460</u>
Sub-total	15,527,991	15,459,472
Less: Accumulated Depreciation	<u>(5,443,841)</u>	<u>(5,112,779)</u>
Net Property and Equipment	<u>\$10,580,632</u>	<u>\$10,346,693</u>

DEBT ADMINISTRATION

Since the SDS does not levy a millage it does not generate property tax revenue. The system charges each of the municipalities for the purpose of funding the debt service on bond issues from 1976 - 2002 based on billable flow within the participating municipalities. Revenue bond indebtedness outstanding at June 30, 2005 amounted to \$4,047,000. New SDS debt was incurred on June 7, 2005 which totals \$370,000. Interest on these loans is payable semi-annually at rates of 2.00 - 5.00%. More detailed information about the SDS's long-term liabilities is presented in note F to the financial statements.

IONIA AREA SEWAGE DISPOSAL SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The amount charged to the participating municipalities is adjusted each fiscal year based on actual costs and billable flows. When the billable flow volume is higher the cost per thousand gallons of sewage can be lower. Conversely, when the actual expenses for the year are higher the cost per thousand gallons can be higher.

When the bond for the 1990 addition to the treatment plant was issued, Orange Township was identified as a partner if they chose to utilize capacity. At that point they did not buy into the system and currently are not served by the SDS. However, recent discussions with Orange Township and the other municipalities have begun. Concerns regarding buying into the current system as well as identifying capacity, future loads, and use of existing lines are issues that need to be addressed before service can be extended to Orange Township.

The City's biggest customer within the SDS is the State of Michigan. The State has committed to paying for 69.44% of the 1976 and 1990 bonds which allowed for improving the system to meet the demands of the prisons served by the SDS. This commitment has helped to keep the debt costs, which are passed on to the individual customers, at a minimum.

TABLE 5
RATES HISTORY

07/01/1999-06/30/2000	\$ 1.088 per 1,000 gallons
07/01/2000-06/30/2001	1.134 "
07/01/2001-06/30/2002	1.262 "
07/01/2002-06/30/2003	1.333 "
07/01/2003-06/30/2004	1.406 "
07/01/2004-06/30/2005	1.440 "

CONTACT INFORMATION

This financial report is designed to provide citizens and creditors with a general overview of the SDS's finances and to demonstrate the SDS's accountability for the funds it receives. Questions regarding this report may be addressed to Cathy Pearce, Finance Director/Treasurer, City Hall, P.O. Box 496, Ionia, Michigan 48846 or by phone at (616) 527-4170 ext. 120 or by email at cathy@city.ionia.mi.us.

BASIC FINANCIAL STATEMENTS

Ionia Area Sewage Disposal System

STATEMENTS OF NET ASSETS

June 30, 2005 and 2004

	2005	2004
ASSETS		
Current assets		
Cash and cash equivalents	\$ 279,161	\$ 530,209
Accounts receivable	3,197	3,883
Due from other governmental units - local	788,699	687,928
Inventory	5,275	3,751
Total current assets	1,076,332	1,225,771
Noncurrent assets		
Cash - restricted	151,595	163,915
Deposit with county	486,894	631,925
Capital assets not being depreciated	496,482	149,776
Capital assets, net of accumulated depreciated	10,084,150	10,196,917
Total noncurrent assets	11,219,121	11,142,533
TOTAL ASSETS	12,295,453	12,368,304
LIABILITIES		
Current liabilities		
Accounts payable	31,777	23,205
Accrued liabilities	7,364	5,605
Due to other governmental units - local	-	61,679
Deferred revenue	151,595	163,915
Current portion of accrued sick and vacation pay	17,363	18,340
Current portion of long-term debt	485,500	475,000
Total current liabilities	693,599	747,744
Noncurrent liabilities		
Accrued sick and vacation pay	52,091	55,019
General obligation bonds payable, net of current portion	3,561,500	3,677,500
Total noncurrent liabilities	3,613,591	3,732,519
TOTAL LIABILITIES	4,307,190	4,480,263
NET ASSETS		
Invested in capital, net of related debt	7,020,526	6,826,118
Restricted for debt service	151,595	163,915
Restricted for capital projects	486,894	631,925
Unrestricted	329,248	266,083
TOTAL NET ASSETS	<u>\$ 7,988,263</u>	<u>\$ 7,888,041</u>

See accompanying notes to financial statements.

Ionia Area Sewage Disposal System

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS

Years Ended June 30, 2005 and 2004

	2005	2004
OPERATING REVENUES		
Sales and charges for services	\$ 981,990	\$ 918,042
Other	23,966	16,642
TOTAL OPERATING REVENUES	1,005,956	934,684
OPERATING EXPENSES		
Administrative	371,072	460,169
Treatment plant	544,234	497,406
Lift station	23,404	12,514
Depreciation	331,062	318,443
TOTAL OPERATING EXPENSES	1,269,772	1,288,532
OPERATING LOSS	(263,816)	(353,848)
NONOPERATING REVENUES (EXPENSES)		
Interest revenue	46,607	40,511
Contributions from local units	527,594	533,150
Interest expense	(174,690)	(89,261)
Contributions to local unit	(35,473)	(69,775)
TOTAL NONOPERATING REVENUES	364,038	414,625
CHANGE IN NET ASSETS	100,222	60,777
Net assets, beginning of year	7,888,041	7,827,264
Net assets, end of year	<u>\$7,988,263</u>	<u>\$7,888,041</u>

See accompanying notes to financial statements.

Ionia Area Sewage Disposal System

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2005 and 2004

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 1,038,582	\$ 891,945
Cash paid to supplies	(552,247)	(523,534)
Cash paid to employees	(278,993)	(245,960)
Cash paid for employee benefits	(164,247)	(150,321)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	43,095	(27,870)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Contributions from local units	527,594	533,150
Contributions to local unit	(35,473)	(69,775)
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	492,121	463,375
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Bond proceeds received	370,000	209,755
Capital purchases	(565,001)	(197,877)
Payment of borrowing	(475,500)	(465,250)
Interest expense	(174,690)	(89,261)
NET CASH USED BY FINANCING ACTIVITIES	(845,191)	(542,633)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest revenue	46,607	40,511
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING YEAR	(263,368)	(66,617)
Cash and cash equivalents, beginning of year	694,124	760,741
Cash and cash equivalents, end of year	\$ 430,756	\$ 694,124

Ionia Area Sewage Disposal System

STATEMENTS OF CASH FLOWS - CONTINUED

Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating (loss)	\$ (263,816)	\$ (353,848)
Adjustments to reconcile operating (loss) to net cash provided (used) by operating activities		
Depreciation	331,062	318,443
Decrease in accounts receivable	686	2,855
(Increase) in due from other governmental units	(100,771)	(25,723)
(Increase) decrease in inventory	(1,524)	2,074
Decrease in deposits with county	145,031	-
Increase (decrease) in accounts payable	8,572	(14,831)
Increase (decrease) in accrued liabilities	1,759	(5,816)
Increase (decrease) in due to other governmental units	(61,679)	61,679
(Decrease) in deferred revenue	(12,320)	(19,871)
Increase (decrease) in accrued sick and vacation pay	<u>(3,905)</u>	<u>7,168</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ 43,095</u>	<u>\$ (27,870)</u>

See accompanying notes to financial statements.

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Ionia Area Sewage Disposal System (System) was created by contractual agreement between the City of Ionia and Ionia, Berlin, Easton, and Orange Townships. The purpose of the System is to construct, improve, enlarge, operate, and maintain all sanitary sewers, storm sewers, combined sanitary and storm sewers, plants, and works used in connection with the collection treatment or disposal of sewage for the benefit of the constituent municipalities.

The allocation of costs of the SDS to the constituent municipalities is based on usage of the system as measured by billable flow. During 1996, the City of Ionia began to directly bill Ionia Township SDS customers. As a result, the City's allocation of costs includes the portion of costs that had been charged to Ionia Township in the past. On December 1, 2001, the City began to directly bill Easton Township SDS customers for operating costs and fixed asset reserves. As a result, the City's allocation of costs includes a portion of costs that would have been charged to Easton Township in the past. The Township continues to make contributions to SDS to fund their portion of the debt service requirements.

Funding of operating costs and the fixed asset reserve as based on annual participant usage is currently as follows:

City of Ionia	92.12%
Ionia Township	4.97%
Berlin Township	2.91%

Funding of debt service as based on annual participant usage is currently as follows:

City of Ionia	89.05%
Ionia Township	4.97%
Berlin Township	2.91%
Easton Township	3.07%

1. Reporting Entity

The accompanying financial statements are exclusive presentations of the financial condition and results of operations of the Ionia Area Sewage Disposal System. The System is considered a "joint venture" of the constituent municipalities.

2. Basis of Presentation

The operations of the System are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. The System's resources are allocated to and accounted for in the individual fund based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The fund in the financial statements in this report is described as follows:

PROPRIETARY FUND

Enterprise Fund - This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

The SDS applies all GASB pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The SDS has elected not to follow FASB pronouncements issued after November 30, 1989 to its business-type activities and enterprise fund.

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
- CONTINUED

3. Measurement Focus

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The proprietary fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the Statement of Net Assets. Fund equity (i.e., total net assets) is segregated into invested in capital (net of related debt) and unrestricted components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

4. Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The proprietary fund is accounted for using the accrual basis of accounting. The revenues are recognized when they are earned, and the expenses are recognized when they are incurred.

5. Budgets and Budgetary Accounting

The City of Ionia operates, administers, and maintains the SDS on behalf of the City and Townships. The annual budget of the SDS is prepared by the City and adopted by City Council. The proposed budget and allocation of costs are submitted to the City and Townships at least sixty (60) days prior to the beginning of each fiscal year. The Townships have thirty (30) days to advise the City of any objections to the proposed budget and allocation. Objections that cannot be resolved are brought before a review board consisting of one (1) appointed member from each constituent municipality and the City Board of Public Works. All actions of the review board are made by a majority vote.

6. Cash and Cash Equivalents

Cash equivalents consist of the System's portion of the City of Ionia's pooled cash accounts. These pooled accounts consist of various checking, savings, certificates of deposit and investment trust funds.

7. Due From Other Governmental Units

Due from other governmental units consists of amounts due from constituent municipalities for debt service and operating costs and amounts due from a component unit of the City of Ionia.

8. Inventories

Inventories in the Enterprise Fund consist of operating materials and supplies, which are stated at cost on a first-in/first-out basis.

9. Capital Assets and Long-Term Liabilities

Capital assets, which include facilities and equipment, are capitalized at total acquisition cost, provided such cost exceeds \$500 and the expected useful life of the asset is more than one year. Depreciation is recorded on all depreciable capital assets on a straight-line basis over the estimated useful lives of the assets.

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

9. Capital Assets and Long-Term Liabilities - continued

The estimated useful lives are:

Sewer plant and improvements	50 years
Machinery and equipment	3 years

Long-term liabilities are recognized in the basic financial statements when incurred. The portion of those liabilities expected to be paid within the next year is a current liability with the remaining amounts shown as long-term.

10. Accrued Vacation and Sick Leave

The System's employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is paid for certain portions of unused accumulated vacation and sick time. This amount has been recorded as a long-term liability in the Proprietary Fund.

11. Comparative Data

Comparative data for the prior year has been presented in the accompanying financial statements in order to provide an understanding of changes in the financial position, operations, and cash flows. Certain amounts presented in the prior year have been reclassified in order to be consistent with the current year's presentation.

NOTE B: CASH AND CASH EQUIVALENTS

In accordance with Michigan Compiled Laws, the System is authorized to invest in the following investment vehicles:

1. Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
2. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the United States government, and which maintains a principal office or branch office located in this State under the laws of the State or the United States, but only if the bank, savings and loan association, savings bank or credit union is eligible to be a depository of surplus funds belong to the State under Section 5 or 6 of Act No. 105 of the Public Acts of 1855, as amended, being Section 21.145 and 21.146 of Michigan Compiled Laws.
3. Commercial paper rated at the time of purchase within the three (3) highest classifications established by not less than two (2) standard rating services and which matures not more than 270 days after the date of purchase.
4. The United States government or Federal agency obligations repurchase agreements.
5. Bankers acceptances of United States Banks.
6. Mutual funds composed of investment vehicles, which are legal for direct investment by local units of government in Michigan.

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE B: CASH AND CASH EQUIVALENTS - CONTINUED

Federal Deposit Insurance Corporation (FDIC) regulations provide that deposits of governmental units are to be separately insured for the amount of \$100,000 for deposits in an insured bank for savings deposits and \$100,000 for demand deposits. Furthermore, if specific deposits are regulated by statute or bond indenture, these specific deposits are to be separately insured for the amount of \$100,000. Michigan Compiled Laws allow for collateralization of government deposits, if the assets for pledging are acceptable to the State Treasurer under Section 3 of 1855 PA 105, MCL 21.143, to secure deposits of State surplus funds, securities issued by the Federal Loan Mortgage Corporation, Federal National Mortgage Association, or Government National Mortgage Association.

Deposits

There is a custodial credit risk as it relates to deposits. In the case of deposits, this is the risk that in the event of a bank failure, the System's deposits may not be returned to it. A portion of the cash and cash equivalents of the System are covered by Federal deposit insurance along with other deposits of the City of Ionia, limited to \$100,000 in total deposits for each bank customer. Since the City maintains these funds in pooled accounts it is not practical to determine what portion of the System's funds are insured.

As of June 30, 2005, the City had funds on deposit with Ionia County of \$486,894 for construction projects and payment of debt service. This amount is considered to be uninsured and uncollateralized.

Credit Risk

State law limits investments in certain types of investments to a prime or better rating issued by nationally recognized statistical rating organizations (NRSRO's).

Interest Rate Risk

The System has not adopted a policy to minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates.

Concentration of Credit Risk

The System has not adopted a policy to minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the System's investment in a single issuer.

Custodial Credit Risk

The System has not adopted a policy to minimize custodial credit risk, which is the risk of loss due to failure of the security issuer or backer.

NOTE C: CASH - RESTRICTED

The restricted cash as of June 30, 2005, of \$151,595 is to be used for future debt payments by the System.

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE D: DUE FROM OTHER GOVERNMENTAL UNITS - LOCAL

A summary of amounts due from other governmental units - local at June 30, 2005 follows:

Due from the City of Ionia LDFA	\$ 697,769
Due from the City of Ionia	81,800
Due from Berlin Township	<u>9,130</u>
	<u>\$ 788,699</u>

NOTE E: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Business-type activities:				
Capital assets not being depreciated				
Construction in progress	\$ 149,776	\$ 346,706	\$ -	\$ 496,482
Capital assets being depreciated				
Sewer plant and improvements	15,189,236	149,444	-	15,338,680
Machinery and equipment	<u>120,460</u>	<u>68,851</u>	<u>-</u>	<u>189,311</u>
Totals at historical cost	15,309,696	218,295	-0-	15,527,991
Less accumulated depreciation for:				
Sewer plant and improvements	5,056,307	304,247	-	5,360,554
Machinery and equipment	<u>56,472</u>	<u>26,815</u>	<u>-</u>	<u>83,287</u>
Total accumulated depreciation	<u>5,112,779</u>	<u>331,062</u>	<u>-0-</u>	<u>5,443,841</u>
Net capital assets being depreciated	<u>10,196,917</u>	<u>(112,767)</u>	<u>-0-</u>	<u>10,084,150</u>
Capital assets, net	<u>\$ 10,346,693</u>	<u>\$ 233,939</u>	<u>\$ -0-</u>	<u>\$ 10,580,632</u>

Depreciation expense in the amount of \$331,062 was reported for the year ended June 30, 2005.

NOTE F: LONG-TERM DEBT

The following is a summary of changes in long-term debt (including current portion) of the System for the year ended June 30, 2005:

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005	Amounts Due Within One Year
1976 General Obligation Bonds	\$ 195,000	\$ -	\$ 95,000	\$ 100,000	\$ 100,000
1990 General Obligation Bonds	2,750,000	-	370,000	2,380,000	375,000
2001 Water & Sewer Improvement Bonds	367,500	-	10,500	357,000	10,500
2004 General Obligation Bonds	840,000	-	-	840,000	-
2005 General Obligation Bonds	-	370,000	-	370,000	-
Compensated Absences	<u>73,359</u>	<u>-</u>	<u>3,905</u>	<u>69,454</u>	<u>17,363</u>
	<u>\$ 4,225,859</u>	<u>\$ 370,000</u>	<u>\$ 479,405</u>	<u>\$ 4,116,454</u>	<u>\$ 502,863</u>

Ionia Area Sewage Disposal System
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE F: LONG-TERM DEBT - CONTINUED

Significant details regarding outstanding long-term debt (including current portion) are presented below:

\$1,600,000 1976 Limited Tax General Obligation Bonds dated July 15, 1976, due in annual installments of \$100,000 through April 1, 2006, with interest at 5.00 percent, payable semi-annually.	\$ 100,000
\$6,382,251 1990 Limited Tax General Obligation Bonds dated August 1, 1990, due in annual installments ranging from \$375,000 to \$415,000 through October 1, 2010, with interest at 2.00 percent, payable semi-annually.	2,380,000
\$3,600,000 2001 Water and Sewer Bonds dated August 1, 2003, due in annual installments ranging from \$100,000 to \$300,000 through October 1, 2020, with interest ranging from 4.00 percent to 5.00 percent, payable semi-annually. The Bonds were issued with the full faith and credit of the City of Ionia. The City is responsible for paying 89.5 percent of the debt, and the system is responsible for paying 10.5 percent of the debt.	357,000
\$4,200,000 2004 Limited Tax General Obligation Bonds dated April 28, 2004, due in annual installments ranging from \$0 to \$300,000 through August 1, 2029, with interest ranging from 3.00 percent to 4.60 percent, payable semi-annually. The City is responsible for paying 80 percent of the debt and the system is responsible for paying 20 percent of the debt.	840,000
\$3,700,000 2005 Limited Tax General Obligation Bonds dated May 27, 2005, due in annual installments ranging from \$2,500 to \$27,500 through August 1, 2029, with interest ranging from 3.50 percent to 4.50 percent, payable semi-annually. The City is responsible for paying 90 percent, which leaves the system responsible for paying 10 percent of the debt.	370,000
	<u>\$ 4,047,000</u>

Compensated Absences

Individual employees have vested rights upon termination of employment to receive payments for unused vacation. The dollar amounts of these vested rights have been recorded in the statement of net assets. They amount to approximately \$69,454 at June 30, 2005.

The annual requirements to pay the debt principal and interest outstanding for the bonds payable are as follows:

<u>Year Ending June 30, __</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 485,500	\$ 114,250
2007	395,500	102,598
2008	428,250	94,266
2009	435,750	85,068
2010	448,250	75,445
2011-2015	680,500	291,827
2016-2020	371,750	220,184
2021-2025	374,000	137,619
2026-2030	<u>427,500</u>	<u>66,545</u>
	<u>\$ 4,047,000</u>	<u>\$ 1,187,803</u>

Ionia Area Sewage Disposal System

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE G: RISK MANAGEMENT

The System is incorporated into the City of Ionia's insurance coverage and as a result is protected from losses. The City carries commercial insurance for the risk of loss due to Workers' Compensation claims.

The City also participates in a State pool, the Michigan Municipal Liability and Property Pool, with other municipalities for property, liability, bonding, and casualty losses. The pool is organized under Public Act 138 of 1982, as amended. The City has no liability for additional assessments based on the claims filed against the pool nor do they have any right to dividends.

OTHER SUPPLEMENTARY INFORMATION

Ionia Area Sewage Disposal System

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET ASSETS - AMENDED BUDGET AND ACTUAL

Year Ended June 30, 2005
With Actual Amounts for the Year Ended June 30, 2004

	Amended Budget	2005 Actual	Variance Favorable (Unfavorable)	2004 Actual
OPERATING REVENUES				
Sales and charges for services				
City of Ionia	\$ 978,012	\$ 954,240	\$ (23,772)	\$ 888,357
Berlin Township	33,382	27,750	(5,632)	29,685
Other	26,640	23,966	(2,674)	16,642
TOTAL OPERATING REVENUES	1,038,034	1,005,956	(32,078)	934,684
OPERATING EXPENSES				
Administrative				
Salaries	47,717	45,946	1,771	46,561
Payroll taxes and fringe benefits	41,189	41,186	3	39,238
Insurance	58,685	58,683	2	59,040
Contractual and professional	11,954	11,952	2	8,929
Administrative	91,719	91,718	1	84,979
Telephone	6,390	5,592	798	6,173
Transportation and training	1,733	1,729	4	1,104
Public utilities	99,437	99,433	4	96,321
Depreciation	329,948	331,062	(1,114)	318,443
Bond issuance costs	-	14,809	(14,809)	116,990
Miscellaneous	102	24	78	834
Total administrative	688,874	702,134	(13,260)	778,612
Treatment plant				
Salaries	230,910	230,295	615	200,759
Payroll taxes and fringe benefits	118,630	117,093	1,537	108,666
Central garage allocation	50	36	14	22
Contractual and professional	60,000	59,166	834	33,567
Operating supplies	80,440	64,178	16,262	87,248
Gas and oil	5,610	5,609	1	3,574
Chemicals	71,095	67,457	3,638	63,570
Equipment rental	400	400	-0-	-
Total treatment plant	567,135	544,234	22,901	497,406

Ionia Area Sewage Disposal System

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET ASSETS - AMENDED BUDGET AND ACTUAL - CONTINUED

Year Ended June 30, 2005

With Actual Amounts for the Year Ended June 30, 2004

	Amended Budget	2005 Actual	Variance Favorable (Unfavorable)	2004 Actual
OPERATING EXPENSES - CONTINUED				
Lift Station				
Salaries	\$ 4,515	\$ 4,511	\$ 4	\$ 406
Payroll taxes and fringe benefits	2,065	2,063	2	2,003
Contractual and professional	7,710	7,711	(1)	-
Repair and maintenance supplies	2,380	2,380	-0-	3,362
Telephone	305	285	20	678
Public utilities	4,505	4,502	3	4,113
Equipment rental	1,955	1,952	3	1,952
Total lift station	23,435	23,404	31	12,514
TOTAL OPERATING EXPENSES	1,279,444	1,269,772	9,672	1,288,532
OPERATING LOSS	(241,410)	(263,816)	(41,750)	(353,848)
NONOPERATING REVENUES (EXPENSES)				
Replacement reserve	(85,000)	-	85,000	-
Capital outly	(110,000)	-	110,000	-
Interest revenue	43,465	46,607	3,142	40,511
Contributions from local units	539,177	527,594	(11,583)	533,150
Interest expense	(662,266)	(174,690)	487,576	(89,261)
Contributions to local unit	(362,690)	(35,473)	327,217	(69,775)
TOTAL NONOPERATING REVENUES (EXPENSES)	(637,314)	364,038	1,001,352	414,625
CHANGE IN NET ASSETS	(878,724)	100,222	959,602	60,777
Net assets, beginning of year	7,888,041	7,888,041	-	7,827,264
Net assets, end of year	\$ 7,009,317	\$ 7,988,263	\$ 959,602	\$ 7,888,041

Note: Budget data is presented for informational purposes only.

Principals

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MANAGEMENT LETTER

Ionia Area Sewage Disposal System
Ionia, Michigan

As you know, we have recently completed our audit of the records of Ionia Area Sewage Disposal System as of and for the year ended June 30, 2005. In connection with the audit, we feel that a certain change in your accounting and administrative procedures would be helpful in improving management's control and the operational efficiency of the accounting and administrative functions. This suggestion is a result of our evaluation of the internal control structure and our discussions with management.

The investment policy of the System should be amended to address the disclosure requirements of GASB Statement No. 40.

During the course of our audit and through discussions with administration, it was noted that the System has not amended their investment policy to address the reporting requirements of GASB Statement No. 40.

Deposit resources often represent significant assets of the System's governmental funds. These resources are necessary for the delivery of the System's services and programs. Effective for the year ended June 30, 2005, GASB Statement No. 40 is designed to inform financial statement users about deposit and risks that could affect the System's ability to provide services and meet its obligations as they become due.

We suggest the System review their current investment policy and make the necessary amendments to address custodial credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Such policies are required to be disclosed in the notes to the System's financial statements by GASB Statement No. 40.

This condition was considered in determining the nature, timing, and extent of the audit tests to be applied in our audit of the basic financial statements, and this report does not affect our report on the basic financial statements dated September 22, 2005.

This report is intended solely for the information and use of the administration of Ionia Area Sewage Disposal System, and should not be used for any other purpose.

We wish to express our appreciation for the courtesy and cooperation extended to us during our audit. We are available to discuss any or all of these suggestions with you and to provide assistance in the implementation of improvements.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

September 22, 2005